

**EMERGING FORMS OF REGIONAL COOPERATION IN EAST
ASIA:
AN EXAMINATION OF BILATERAL FREE TRADE
AGREEMENTS AND THEIR TRADE AND INVESTMENT
CONSEQUENCES ***

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1. Introduction

East Asia is always in the limelight. In the early 1990s, the growth of countries in East Asia was so high, and the transformation from less developed to newly industrialising economic status was so fast that many would call this phenomenon 'an East Asian Miracle'. Then towards the end of the 1990s disasters struck, and many of these miracle economies were humbled by serious financial and economic crises. Recovery was relatively rapid, nonetheless, and many of these economies are now on the mend. Now many of these East Asian economies are engaging in some economic innovations that make news throughout the international economic and business circles: They are pursuing, with great enthusiasm, bilateral free trade agreements (FTAs) among themselves as well as with other countries across the Pacific. ¹ New Zealand and Singapore concluded an FTA in November last year. Singapore and Japan has just finished their joint study on the effects of their so-called New Age FTA, and now in the process of negotiation for the final agreement expected at the end of 2001. Japan is also planning to enter into an agreement with Korea and Chile. Korea also would like to do it with Chile. Singapore has already started talk with Mexico and there should be some progress on this agreement soon.

Can we call this wave of new developments economic innovations? Many would not accept that, as bilateral FTAs and similar forms of regional or subregional trading arrangements have been in existence for a long time. Of course what is meant by FTA here is a broad term that describes various forms of regional cooperation including free trade area, customs union, common market, and economic union. The mother of all FTAs today is

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¹ Note that FTA here is free trade agreement, not free trade area, as the same abbreviation may be used in some other literature.

probably the European Union which has developed step by step from a free trade area to a customs union and finally to an economic union. In North America, the North America Free Trade Area or NAFTA is approaching its 10th anniversary. In South America, MERCOSUR grouping between Argentina, Brazil, Paraguay and Uruguay is a well-established FTA. Even in Southeast Asia itself, the Association of Southeast Asian Nations or ASEAN which has been in existence since 1967 is gearing towards the eventual AFTA or ASEAN Free Trade Area in 2003. According to the World Trade Organisation or WTO, more than 200 FTAs have been registered or notified as of the middle of last year, and over 130 of these are currently in force.² So, what else is new?

The answer lies in the intricate linkages of these new FTAs in East Asia with the Asia Pacific Economic Cooperation or APEC which is probably the most well-known economic grouping in the world today after the European Union. Strange as it may seem, what makes these new East Asian FTAs unique is because they are being formed by members of APEC, which already have set the goals for free trade arrangements among themselves (by 2010 for developed members, and 2020 by developing members). If APEC is already aiming for free trade in the region, why should there be any overlapping attempt or effort to create a separate bilateral FTA? The potential conflict between this new FTA and the APEC process itself is already causing puzzles among international economic experts, and thus a source of intrigues. Some would even go so far as to say that these emerging new FTAs would actually spell an early demise for APEC. Others would think otherwise, believing that there is no real deleterious conflict between the new FTAs and the APEC process. Indeed, the opposite is true that the new FTAs would bring about an early realisation of APEC goals of freer trade and investment in the Asia Pacific region. The above puzzles and ensuing debates should be enough to convince doubters that the bilateral FTAs in East Asia as an emerging form of regional cooperation is not an ordinary FTA. That is why it will be called New FTA in this paper. And if this form of FTA succeeds within the context of APEC, it could be rightly called a worthy economic innovation.

In the ensuing sections of this paper, therefore, we will try to examine and analyse the New FTAs among member of APEC in East Asia and the Pacific region as to their strengths and weaknesses, the opportunities and threats to the APEC process, and the prospects that these FTAs may coexist with their continuing support and active participation in APEC. After this introduction section, Section 2 looks at the traditional debate on pros and cons, or the benefits and costs, of FTAs, taking into account both theoretical and empirical investigations that have

² Source: WTO, July 2000.

been conducted in various places throughout the world. Section 3 discusses the unique development of APEC as a precursor of a much larger and much more beneficial free trade arrangement, and how it affects the advent of the New FTAs. Section 4 examines some highlights of these new East Asian FTAs, especially the one that has already been established between New Zealand and Singapore, the one that is being negotiated between Singapore and Japan, and the forthcoming launch of discussion between Japan and Korea. Section 5 briefly considers the trade and investment consequences or implications of both APEC and these New FTAs. Finally, Section 5 concludes and provides some remarks on the future of these FTAs as an emerging form of regional cooperation in East Asia.

2. The Benefits and Costs of an FTA ³

The debate on the benefits and costs of a free trade arrangement especially in the form of a customs union dated back to 1950 when Jacob Viner coined the terms ‘trade creation’ to describe welfare change (gain) due to the replacement of higher-cost domestic production of imported goods with lower-cost imports, and ‘trade diversion’ which describes welfare change (loss) due to the replacement of imports from a low cost source to imports from a high cost source. So, basically a customs union is beneficial to members if it has caused trade creation, but detrimental to members if it has caused trade diversion. But from then on several researchers and scholars have had opportunities to examine the benefits and costs, or the pros and cons, of a free trade arrangement. For example, in 1955, James Meade published a book on theory of customs union; in 1971, Jagdish Bhagwati wrote an article on customs unions and their welfare implications; in 1976, Murray Kemp and Henry Wan published an article which later became the origin of what is now known as the Kemp-Wan Theorem. This theorem argued that if we allow the possibility of costless redistribution between members, and the ability to set common external tariff at an appropriate level, then it is possible to prove that a customs union needs never harm any country. ⁴

Theoretical debates on the effects of customs unions and other forms of economic integration simmered down somewhat in the late 1970s and 1980s but picked up again in the 1990s. This could be because of several important events that marked

³ This section draws mainly from Christopher Findlay (2001).

⁴ For the most recent and most comprehensive survey of theoretical studies on various categories of free trade arrangements, see Arvind Panagariya, “Preferential Trade Liberalisation: the Traditional Theory and New Developments”, *Journal of Economic Literature*, vol. 38, June 2000, pp. 287-331. It should be noted, however, that Panagariya only surveyed the literature on preferential liberalisation of tariffs on goods, and nothing on ‘trade agreements’ where trade preferences play no explicit role.

meaningful economic integration and regional cooperation episodes: the successful conclusion of the Uruguay Round of multilateral trade negotiations, the development of European Single Market, the establishment of Asia Pacific Economic Cooperation (APEC), the successful launch of the North American Free Trade Area (NAFTA), and so on. This has spurred several studies on free trade arrangements again. But the situations in the 1990s have become more complex. Advanced technology has increased the speed of communications and telecommunications, and the adjustments and changes in the behaviour of the people have also become more rapid. This has a great deal of impacts on how new international trade could benefit or harm trading partners and the people in each trading country, and the non-member countries and their people. There are little disagreements among economists as to the benefits of multilateral trade liberalisation. Built on the simple but powerful theory of comparative advantage where specialisation and free trade bring about gains from trade to all trading partners, multilateral free trade system is, at least theoretically, to be preferred to preferential trading system. But then why a rush to preferential agreements among two or few members? In the last few years, a series of new studies on these preferential trading system vs. multilateral free trade system have been published which have shed more lights on the new thinking on the new free trade agreements. We will take a look at some of these arguments on the positive as well as negative sides.

Positive Effects of FTAs

Apart from the positive effects of trade creation as a result of customs union or other forms of preferential trading arrangements, we have seen other arguments as well. For example, there is a terms of trade effect as a result of preferential arrangement in such as a way that members' terms of trade improve.⁵ There is also a possibility of the relocation of rents away from non-members or foreign firms in a member country. For example, a preferential arrangement may lead to entry by firms from other members into the imperfectly competitive market of a member of whom some of the profits were captured by foreign firms. The same preferential arrangement can also bring about opportunities to exploit economies of scale as well as the diversion of flows of foreign capital from non-members to members. But as Krueger points out in her recent paper, despite all these positive effects, it is difficult to come up with firm general rules about when a preferential agreement is good for members. It is normally believed that if the existing level of trade is high, the extent of costly trade diversion

⁵ This can happen when a small country, which is a member of a customs union, gains by diverting its trade away from a large non-member country which determines world prices and which imposes a tariff on this small country's imports. See Findlay (2001) in this argument which he attributed to the work of Neil Vousden of Australian National University.

will be less. Another condition is that if the external tariffs at the time of establishment of preferential trade agreement are low, then the chance of significant losses from trade diversion will be low too.⁶

Christopher Findlay surveyed some of the recent studies on the positive effects of preferential trade arrangements and reported that there is what is known as the dynamic time path effects, or in other words, preferential arrangements build the momentum for further multilateral liberalisation. The preferential agreements between Australia and New Zealand (so-called Closer Economic Relations or CER) are often used as an example of this time path effect. Findlay also reported a study by Caroline Freund on serial bilateralism, that is when the outcome of a bilateral agreement is good or beneficial, each country will want to sign an agreement with every other country. The benefits from this bilateral agreement may include higher profits from preferential access to foreign markets, and higher consumer surplus at home. These gains always outweigh the loss of profits in the home market and the loss of tariff revenue from offering access to foreign suppliers at preferential rates. According to Freund, this is the case whatever agreements are already in place and whatever other economies have done. The consequence is that the best strategy for each economy is to have a bilateral agreement with every other economy. In this model uncoordinated bilateralism will lead to free trade. Findlay summed up other benefits of preferential agreements as follows:

- Preferential agreements help 'lock in' policy change. Policy change which is announced by which is not credible will not have any impact. The commitments made in a preferential agreement provide one way of adding to the credibility of policy change, since backsliding will be punished by loss of the advantages provided by the agreement.
- Preferential agreements may lead producers in economies with high external tariffs to argue for lowering those tariffs, especially the ones applying to intermediate goods.
- Preferential agreements can be used as a threat to promote the multilateral process. They can help participants go further than they could in the multilateral system. They can establish deal with new policy issues and with emerging impediments to trade and investment. Also, a preferential approach is said to help the process of education about free trade and its benefits.

Negative Effects of FTAs

At least five negative views on FTAs could be listed:

⁶ See Anne O. Krueger (1999).

- Benefits from preferential agreements can also come from a general liberalization of trade, and will also be larger in that case.
- Members of preferential agreements are more likely to raise barriers to non-members, even when external tariffs are low.
- Preferential structure may bring about or create rents members. But once they get used to the benefits from these rents, members do not want to give them up as they cannot be compensated by the move to freer trade. This is the 'snout in the trough' phenomenon as Findlay has called it.
- Negotiation of preferential agreements uses up scarce policy making and negotiating capacity and diverts attention in the policy making system.
- Other multilateral mechanisms provide even better benefits than those claimed for a preferential agreement. The WTO for example provides mechanisms for binding policy that avoid the disadvantages of trade diversion.

Assuming that FTAs contain or cause negative effects, or at least not clearly superior to multilateral trading systems, why there are so much on-going rush to form FTAs in the world today, especially in East Asia? One clear answer is the loss of confidence among private investors in the multilateral process. An analysis by John McLaren of Columbia University (as reported by Findlay) is interesting. In McLaren's model, investors in a given country will behave according to the expectations of the world trading systems. If free trade on a global basis is expected, these investors will invest in areas where they have a comparative advantage. If instead trade blocs are expected, then, they will invest differently. In the latter case, firms within bloc will invest more in the sectors supplied by goods exported by non-members, and they will also become more specialized relative to one another. In this case the actual gains from a preferential agreement will exceed those from multilateral liberalization. If in addition, there are 'negotiating frictions' which make the multilateral liberalization process costlier, then, ex post, multilateralism might not be worth the effort. The expectation of its failure creates a new set of investments, leading to the realization of a preferential outcome.

In 1995, Richard Baldwin (1995) presented another interesting theory behind the increase in regionalism. According to him, expansion of trade bloc depends on the willingness of the existing members of offer entry and the incentives facing outsiders to seek entry. These outsiders face 'non-economic' costs of getting into the bloc, and these costs increase as more have been admitted into the bloc. This means that successive countries require larger and larger economic incentive to seek entry. At the initial equilibrium, the economic benefit of membership to the last member in the bloc equals its non-economic cost. Assuming that

the profitability within the bloc increases, the potential economic benefits of entry for the next country must also increase. The bloc expansion has created a 'domino effect' that may eventually encompass the whole world, leading to the global free trade. Recently, Gandal and Shy (2001) looked at the incentives for a preferential approach from the point of view of the recognition of standards. In their study model, targeted economies face a choice of recognizing all standards after a union or none of them. They were able to show that welfare of members is maximized if they recognize all standards. This mutual recognition of standards within the preferential system will eventually lead to the universal mutual recognition of standards which signifies the global trading system.

The above are just a few analyses that we have found in a recent literature on the debate on regionalism vs. multilateralism. But it suffices to show that there are reasons to explain, on theoretical terms, the increase of regionalism within the proven beneficial system of multilateral trade agreements. Perhaps we should look at the empirical evidence as well whether preferential agreements have different effects on trade and welfare compared to multilateral agreements. Findlay (2001) conducted a few surveys of the empirical findings of the impact of preferential agreements on trade and welfare, and the followings are the summary of some of those findings.

- Anderson and Norheim (1993) apply and extend a set of indicators which can be used to comment on the extent to which preferential agreements have affected the growth in the propensity of members of preferential agreements to trade outside the group. Their conclusion is that global integration has deepened despite the greater number of and coverage of preferential agreements. But they still stress that the world might still have been a better place without the agreements.
- Laird (1999) looked at the shares in total exports over the 1990s up to 1997 of within-group and out-of-group trade for a series of preferential arrangements, and compared the growth of these two types of trade. The picture is mixed. Trade grew faster among members than with non-members in many agreements but at about the same rate for both groups in the case of the European Union. Also trade with non-members in many cases actually grew faster than world trade on average.
- Srinivasan, Whalley and Wooton (1993), reviewed a large number of studies using computable general equilibrium models on the welfare effects free trade areas and customs unions and found that the welfare effects of preferential agreements are probably positive but not necessarily very

large. They suggested that those who are in favour of, or oppose, preferential agreements are probably overstating the quantitative assessments in support of their case.

- Davis, McKibbin and Stoeckel (2000) used a quantitative model to simulate the effects of a free trade area involving AFTA and CER, and found positive effects of a joint AFTA-CER free trade area (see more on this later). They have also found that if APEC proceeds to form its free trade area on schedule, then the additional gains from negotiation of the AFTA-CER arrangement will be relatively small.

Here, again, the results are inconclusive as to whether preferential agreements increase or reduce trade and welfare of members and non-members, or whether preferential agreements will definitely harm multilateral agreements. It seems that factors outside the strict economic welfare considerations may play an important role in influencing countries to enter into preferential free trade agreements. Perhaps it is appropriate now to consider the real cases of FTAs that have taken place in East Asia in the last few years. But we will do this under the context of the APEC process. In other words, we will analyse these recent FTAs on the premise that contracting parties are members of APEC and participate fully in other aspects of Asia Pacific economic cooperation. Under this assumption, the picture emerged from the result of the analysis may be different from the approach whereby APEC has little or no effect on the decision to enter into a preferential agreement.

3. APEC and the New FTAs

We will ask a series of questions in this section to get a clear picture on the relationship between APEC and the New FTAs. The first question is: What is APEC, and what connection does it have with an FTA? Despite its well-known name and high-profile existence, few can profess to know exactly what APEC is. It is neither a trade bloc nor an FTA because it does not bind members to a certain compulsory rule concerning trade. Neither is it a general agreement like GATT which also binds members to follow certain rules or procedures with provisions for sanctions or penalties if that member refuses to abide by them. It can be looked upon as an international organisation, like the OECD, but without large or centralised organisational structure and well-defined international bureaucracy. Perhaps the original definition by Professor Yamazawa Ippei of Japan would capture the true essence of APEC. To him, APEC is an open economic association. (Yamazawa, 1992). It is open because it does not seek to discriminate against non-members. It is economic because it deals basically with economic growth, trade and investment. And it is an

association because participants do not cede powers of regulation or enforcement to any supra-national regional institution. Unlike GATT and its metamorphosis, the WTO, APEC is a voluntary organisation based on consensus aiming at free and open trade and investment in the region, not a rules-based organisation with sanction power like the WTO.

The second question is: If it is so loose like this, who would be interested in joining? Many. Indeed, from its inception in 1989, where 12 market-oriented nations formed the first group of members, APEC has expanded to include, by 1999, 21 members. And many have expressed their intention to join in as new members to the point that existing members have to declare a moratorium on new members until 2007. To avoid sticky diplomatic point about sovereignty issues, members are called 'economies' rather than 'countries'. These economies join APEC because they believe in free trade and investment and are willing to work toward the ultimate objective of free trade in the Asia Pacific region voluntarily and unilaterally along with other members in this unique association or organisation. Because APEC works as a group, its action is perceived to be multilateral in the WTO sense. It is leading as well as supplementing WTO at the same time, leading because it already set the target date for free trade in the Asia Pacific region by 2020 at the latest, and supplementing because it adopts the WTO principle of non-discrimination and most-favoured-nation treatments to all members. And APEC members do these multilateral commitments unilaterally and without reciprocity.

The third question is: If the setup is so progressive and forward-looking, and in the best tradition of desirable multilateral trade liberalisation, then why so many APEC members opted out to spawn many bilateral FTAs among themselves? There are at least 3 reasons for this. The first reason is that, although all APEC members are basically pro-free trade, there are certain sectors in some economies that require more time to adjust to the new competitive economic conditions brought about by free trade. The time horizon for free trade in the region to take place (2010/2020) seems reasonable enough for this to materialise. But to force an early uniform liberalisation in certain sectors like an attempt at an early voluntary sectoral liberalisation or EVSL by APEC in 1998 was somewhat premature, and this has proved to be the case when APEC members failed to agree on this EVSL efforts in 1998. APEC is not a forum for this kind of trade negotiation; WTO is. But APEC members who are ready may go ahead with their FTAs while they still work inside APEC for the system-wide liberalisation. The second reason is that in the absence of any new multilateral trade negotiations a la WTO, the momentum towards trade liberalisation may be losing. So, new FTAs could be looked upon as an attempt to stimulate movement or pressure towards a new round of

multilateral trade negotiations. And the third reason is that an FTA under or within APEC is WTO-consistent, that is does not want to discriminate against any particular APEC members. In fact, most of new FTAs under or within APEC will provide accession clause for other APEC members to join in if and when they see that they are ready for it.⁷

Yet there are still those who believe that a subregional trading arrangements in the form of FTAs among APEC economies are not necessarily always a good idea as these arrangements are likely to divert attention from the wider objectives of the APEC process and its commitment to open regionalism, and strain its cohesion. An example of one who holds this view is Andrew Elek of the Australian National University who was one of the early proponents and indeed initiators of APEC (see Elek, 2000). Elek believes that, even with the best of intentions, it will not be easy for FTAs partners to address the relatively new issues of barriers to trade and investment and other significant impediments to international commerce without creating new discrimination and diversion of economic activity. If these relatively new issues are addressed in association with a preferential FTA, these arrangements could be discriminatory by default. To him, FTAs that are consistent with the Bogor goals of APEC must satisfy two conditions: one, they must be comprehensive, covering all trade in goods and services, and two, the schedule for eliminating borders barriers to trade among members is to be completed by 2010 for any developed economies or by 2020 for any developing economies involved in such arrangements. A better suggestion is to adopt what is known as 'cooperative arrangements' that go beyond, say, FTA for goods and/or services to include arrangements to facilitate trade and investment such as a dispute settlement procedure. Elek proposes a set of guiding principles which were built on already-agreed APEC principles with emphasis on transparency, avoiding new obstacles to trade and investment, and creating objective, non-discriminating opportunities for accession.

⁷ To form a preferential trading arrangement that is WTO-consistent, trading partners must follow Article 24 of the GATT/WTO. GATT article 24 allows countries to grant special treatment to one another by establishing a customs union or free-trade association, provided that (1) duties and other trade restrictions are "eliminated on substantially all the trade" among the participants, (2) the elimination of internal barriers occurs "within a reasonable length of time" (commonly interpreted as permitting a phase-in period of not more than 10 years), and (3) duties and other barriers to imports from nonmember countries "shall not on the whole be higher or more restrictive" than those preceding the establishment of the customs union or free-trade association. The third condition was explicitly aimed at protecting the rights of outside countries.

Other critics of a non-WTO-typed liberalisation (not necessarily only FTAs, but sector-by-sector liberalisation as well) are Vinod K. Aggarwal of the University of California at Berkeley and John Ravenhill of the University of Edinburgh who caution against being misled by the past successes in sectoral agreements in telecommunications, financial services, and information technology.⁸ They believed that the success in the ITA case is a special case which is unlikely to be repeated in other sectors. Therefore, the continuation of sector-by-sector trade liberalisation or what they would call, 'Open Sectoralism' is fraught with political and economic hazards. They cited the APEC's experience with sectoral liberalisation where political difficulties arise while constructing a package that will satisfy all participating governments when negotiations are conducted in only a limited number of sectors. According to Aggarwal and Ravenhill, in such circumstances domestic protectionist interests are mobilised. Without a comprehensive approach to trade negotiations, the political influence of these protectionist forces cannot easily be offset by groups with a strong interest in the liberalisation of other sectors. Economically open sectoralism often concentrated in areas where there were few impediments in the first place, but protection is maintained elsewhere. The result is to increase rather than reduce distortions in the domestic economy. They concluded that liberalisation of some sectors and not others undermines broader, more inclusive efforts, while temporary protection of some sectors can be worthwhile if it allows broad scale liberalisation elsewhere. They believed that to promote widespread trade liberalisation and efficient resource allocation, one must return to multisector, multiproduct negotiations, and the tradeoffs that such discussion entails.

As it will become clear when we discuss several bilateral and other regional FTAs in the next section, most of the above dissenting points have been taken care of in the New FTAs that have cropped up in East Asia in the last few years. Suffice it to say that the influence and pressure of APEC have borne on the patterns of behaviour of APEC members who decided to go the FTA route in tandem with their continued participation and support of APEC. In fact, not only that these New FTAs are WTO-consistent, they are—to use the jargon used by Andrew Elele, APEC-consistent. Therefore, APEC has definitely established some positive connections with the New FTAs.⁹

4. Salient Characteristics and Features of East Asian FTAs

⁸ See Aggarwal and Ravenhill (2001).

⁹ For information on how APEC works and how it has influence on the minds of policy makers in APEC, see Box 1.

That East Asia is a newcomer in the FTA business is beyond any doubt, but the stories behind the formation (or prospective formation) of East Asian FTAs are no less unique and interesting than those in other parts of the world. This section will take a look at salient characteristics and features of some of the East Asian FTAs or prospective FTAs.

(a) ASEAN Free Trade Area (AFTA)

The agreement to deepen the economic cooperation among, then, 6 countries of the Association of Southeast Asian Nations or ASEAN to a free trade area was concluded in early 1992, but the establishment of ASEAN itself dated as far back as 1967. It is true that there was not much economic activity among ASEAN members during its two decades of its existence, but after most of these ASEAN member countries started to grow quickly each on their own in the latter half of the 1980s, economic activities among members increased. It is ironic that despite its relative economic inactivity in the 1970s and 1980s, ASEAN had maintained its strong presence as a regional political grouping, with its effective 'ASEAN Solidarity' that, among other things, helped bring about settlement of conflicts in Cambodia. Economic activities and prosperity in the 1980s and early 1990s have given rise to the prominence of ASEAN as an influential regional economic grouping while maintaining its strong political role through new political and security activities forum called ASEAN Regional Forum or ARF.

At the heart of the economic components of AFTA is the Common Effective Preferential Tariff (CEPT) scheme which involves the phasing down of intra-ASEAN tariffs to a range of 0-5 per cent as well as the elimination of non-tariff barriers over a broad range of goods by the end of 2002.¹⁰ The ultimate target is to eliminate all customs duties by 2010 for the first six members (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand), and 2015 for the four newer members (Cambodia, Laos, Myanmar and Vietnam). And apart from this basic liberalisation in trade in goods, ASEAN members also agreed to liberalisation of trade in services beyond their commitments under the General Agreement on Services (GATS) of the WTO, and to liberalisation of investments by signing the ASEAN Framework Agreement on Services (AFAS) and the Agreement to establish ASEAN Investment Area (AIA) during the 5th ASEAN Summit in 1995. Other elements of regional cooperation include trade facilitation, technical assistance among members, protocols on rules and disciplines, and openness to other regional groups.¹¹

¹⁰ The original ending period was 2005 but this was moved forward to 2003 and finally to 2002 during the 6th ASEAN Summit in December 1998 in Hanoi.

¹¹ It should be mentioned that difficulties arising from some ASEAN members' inability to meet the CEPT obligations by the year 2002, especially by Malaysia in its auto industry, forced ASEAN members to do an about-face by endorsing the

(b) Closer Economic Relations (CER) between Australia and New Zealand, and the Proposal for an AFTA-CER Free Trade Area

This common name, CER, has become known for the free trade agreements between the two oceanic countries, Australia and New Zealand, which was concluded in 1983. Throughout the last two decades, the CER has developed to the point that, not only all tariffs and quantitative restrictions on trade in goods are eliminated, but much further actions on liberalisation were also accomplished, including the elimination of all export incentives and subsidies and anti-dumping measures. The agreement as it is today also covers services and addresses the harmonisation of a range of non-tariff measures that affect the free flow of goods and services, including those relating to quarantine and customs issues, standards and business laws.

What is more interesting is the proposal by the CER to enter into an FTA with ASEAN. This was started during the informal consultations between economic ministers of ASEAN and the CER in 1995 and has developed into the proposal for AFTA-CER Closer Economic Partnership (CEP) in 2000. This proposal probably gives the most comprehensive coverage of FTA features than any FTAs in East Asia to date. There is still a long way to go for this prospective FTA, but once this AFTA-CER FTA is established, it could be the benchmark against which all other FTAs could be measured (See Box 2 for detailed conditions for this FTA).

(c) Agreement between New Zealand and Singapore on a Closer Economic Partnership (ANZSCEP)

While the AFTA-CER FTA is still on the drawing board, another FTA between two members of ASEAN and CER has already been concluded. This is Agreement between New Zealand and Singapore on a Closer Economic Partnership, which is the full name for what otherwise is known as the New Zealand-Singapore FTA, which, incidentally, is also the first New FTA in East Asia from among APEC members. New Zealand and Singapore are not large trading partners in comparison with other nations, but both have similar important economic characteristics. Both are small and very market-oriented, and because of their smallness, their economic future depends on trading with other nations. The decision to enter into an FTA is much more than the wish to abolish tariffs on trade on goods between themselves, but a much larger economic objective of stimulating freer trade and closer economic cooperation in the Asia Pacific region. A look at the official text of the agreement on the objective of this agreement will tell the story.

Protocol Regarding the Implementation of the CEPT Scheme Temporary Exclusion List during the 32nd ASEAN Economic Ministers Meeting in Chiang Mai in October 2000 which was signed by ASEAN leaders during the 4th ASEAN Informal Summit in Singapore in November 2000.

The objectives of New Zealand and Singapore in concluding this Agreement are:

- a) to strengthen their bilateral relationship through the establishment of a closer economic partnership;
- b) to liberalise bilateral trade in goods and services and to establish a framework conducive to bilateral investments;
- c) to support the wider liberalisation process in APEC and in particular the efforts of all APEC economies to meet the Bogor goals of free and open trade and investment by 2010 at the latest for industrialised economies and 2020 at the latest for developing economies;
- d) to support the World Trade Organisation (WTO) in its efforts to create a predictable, freer and more open global trading environment;
- e) to improve the efficiency and competitiveness of their goods and services sectors and expand trade and investment between each other;
- f) to establish a framework of transparent rules to govern trade and investment between them; and
- g) to accord fair and equitable treatment and protection to bilateral investments.

Objective (c) is very important in the context that we are discussing in this paper. This is the first time that a reference is made explicitly to APEC in the process of their FTA, to show that there is no conflict between the existing concept of APEC and the New FTA. Indeed, the opposite is true that the New FTA could help APEC realise its Bogor goals faster. Objective (e) is also a new addition to the dynamic effects of FTA, that the New FTA is not just for preferential trade alone, but an opportunity to improve efficiency in the economy for greater competition and economic expansion through investment. Perhaps the statement by the Prime Minister of Singapore, Mr. Goh Chok Tong, at the signing ceremony of this Agreement in Singapore in November 2000 captures the essence of this FTA well. Mr. Goh, said, in part:

“...This FTA is a milestone in our bilateral relations. Ties between our two countries have always been strong. But our FTA marks the beginning of a new chapter of an even more intense and closer friendship.

Economically, this Agreement will open up new opportunities for businessmen from both countries. It will help Singapore companies exporting to New Zealand. Conversely, while the regime in goods in Singapore has traditionally been open, we have made substantial commitments in the area of services for New Zealand companies.

The benefits of FTAs are not limited to securing better access to markets. FTAs can also provide an additional impetus for economies to restructure to meet the challenges of the New Economy. The increased competition for our local companies resulting from the New Zealand-Singapore FTA will sharpen our economic competitiveness. This is true also for both New Zealand and Singapore.

The New Zealand-Singapore FTA has also helped us achieve our wider strategic goals. We set out a year ago with the objective of using a New Zealand-Singapore FTA to catalyse APEC towards its Bogor Goals. The intention was to spin a web of inter-locking FTAs between APEC members, which would help move the organisation towards achieving free trade in the Asia Pacific.

We are today many steps closer to achieving an APEC-wide FTA.

FTAs, however, should not be pursued at the expense of the multilateral trading system. We must continue to invest efforts towards the launch of a New Round, to ensure that the gap between FTAs and the WTO does not grow so wide that it becomes irreconcilable. A global environment dominated by FTAs may leave behind those countries which are unattractive FTA partners. Hence, it is important that FTAs lead to a new round of negotiations under the WTO".

The ANZSCEP came into force on January 1, 2001. On the last day of the same month, officials of Singapore began formal negotiations on forming another FTA with another APEC member, Japan. Once this agreement is completed and the new FTA launched (expected at the end of 2001), the world will witness another spectacular economic event.¹²

(d) Japan-Singapore Economic Partnership Agreement (JSEPA)

¹² Not everyone is ecstatic about this FTA between Japan and Singapore. The role of Singapore as a keen initiating party to set up an FTA was actually criticised by some. Jesus Estanislao, former Dean of the Asian Development Bank Institute in Tokyo commented: "Singapore is going to bed with almost every country but disregarding ASEAN. This is not a coalition of the willing in ASEAN, it is a coalition with one economy jumping over the regional fence and dealing with everybody else. That doesn't build a structured relationship, as a matter of fact that will marginalise ASEAN" (Allison, 2001, p. 4). Rodolfo Severino, the Secretary General of ASEAN Secretariat also commented that FTA of the type that Singapore is entering into with Japan could dishevel the road map of globalised trading under the WTO. It could lead to discriminatory treatment if we were not careful. "If an FTA is WTO-consistent—that it follows WTO rules and not raise new barriers against non-members—then that's OK", he said.

The above is the formal name for the Japan-Singapore FTA. This FTA, once concluded, will be an even bigger milestone for regional cooperation in East Asia as well as in APEC. For Japan, this FTA will represent a major shift in its foreign economic policy. Since the War, Japan has always been a great supporter of multilateral trading system. Traditionally Japan had shunned bilateral or regional free trade agreements for fear that they were detrimental to the development of multilateral trading system. As Marc Castellano of the Japan Economic Institute remarks, the primary concern was that regional trade pacts, exclusionary by definition, would anger outsiders and lead to more protectionism, which, in turn, would hurt the growth of the world trading system.¹³ Then the Japanese perspectives began to change during the prime ministership of Mr Obuchi Keizo. In May 1999, the Japanese Ministry of International Trade and Industry (MITI) released its 1999 Trade White Paper, highlighting three main reasons for the shift of policy. First, MITI believed that agreements like NAFTA and MERCOSUR have expanded trade and investment flows among members. Second, countries that maintained low government and commercial barriers to trade were likely to benefit more in an era of rapid globalisation. And finally, during the seven rounds of multilateral trade negotiations conducted by GATT, integrated blocs played an important role in enhancing the development of the international trading system. In May 2000, MITI's White Paper on International Trade 2000, again endorsed the policy shift toward bilateral or regional trade agreements.¹⁴

But by then Mr Obuchi, the Japanese Prime Minister, had actually already made up his mind to go ahead with this new FTA. During Mr. Goh Chok Tong's visit to Japan in December 1999, the two prime ministers agreed to set up a joint study group to examine the feasibility and desirability of establishing a free trade agreement between the two countries. A 25-member Joint Study Group was set up to consider the following issues:

- a) The architecture and scope of the FTA. Both the traditional areas of liberalisation of trade in goods and services and of investment, as well as bilateral cooperation in other areas, will be discussed. This is the primary intention to establish a 'New Age' FTA.
- b) Such an FTA would have to be consistent with the WTO rules.
- c) Either country will have the flexibility to take into account sensitive areas including the possible exclusion of sensitive

¹³ Marc Castellano, 'MITI hails regional free-trade agreements, urges Japanese participation', in JEI Report, no. 21, May 26, 2000.

¹⁴ Since December 2000, the Japanese bureaucracy has been reorganised. The Ministry of International Trade and Industry (MITI) is now Ministry of the Economy, Trade and Industry (METI).

items in such areas as agriculture, forestry and fishery sectors.

- d) Consideration of strategic and economic benefits that both Japan and Singapore could derive from the establishment of such an FTA.

After 6 months, the work of the Joint Study Group was completed, and the Report was submitted to the governments of both Japan and Singapore in September 2000. It is still interesting to look at the reasons this Joint Study Group used to support this New Age FTA. In its opinion, FTAs in the past were regarded as precursors to economic blocs, and therefore stumbling blocks to the GATT/WTO. Now, no FTA can afford to be inward looking, because globalisation has made markets much more inter-linked and inter-dependent. The Joint Study Group also believes that FTAs which are WTO-consistent can have a positive ratcheting effect on global trade liberalisation. FTAs are now seen as an essential tool of international trade policy, complementing the multilateral trading system. In particular:

- a. Because they are easier to conclude than multilateral agreements, FTAs can serve as building blocks towards multilateralism, helping to sustain the momentum of global trade liberalisation;
- b. FTAs can be a testbed for new and innovative models of rules governing economic activity; and
- c. Since FTAs are formed between a small number of partners and at a pace that is comfortable to all parties, they are an effective means of preparing societies for greater transborder exposure at the multilateral level. They provide an important demonstrative effect of the benefits of trade liberalisation without attracting a severe backlash against liberalisation.¹⁵

(e). Japan-Korea Economic Agenda 21

The original name for this prospective FTA between Japan and Korea is Action Plan for the New Korea-Japan Partnership for the 21st Century. It was suggested by President Kim Dae Jung himself when he visited Japan in October 1998 to make the Korea-Japan economic relationship closer. In his return visit to Korea in March 1999, Japanese Prime Minister, Mr Obuchi, proposed to go further beyond existing economic cooperation framework toward the strengthening of bilateral relations through a Japan-Korea FTA under the name Japan-Korea Economic Agenda 21. The Institute of

¹⁵ Joint Study Group (2000), p. 1-11. In a related document, the Japanese Federation of Economic Organisations (or Keidanren in Japanese), has given its strongest support to the Japanese involvement in the formation of FTAs with other East Asian trading partners. It even draws up a model or template for a typical FTA that any interesting countries can use. See Box 3.

Developing Economies (IDE/JETRO) in Japan and the Korea Institute for International Economic Policy (KIEP) in Korea were tasked to study the possibility of forming this FTA together, and preliminary results have already been made available to the public.

¹⁶

It was reported, at least from the Japanese side, that when the agreement comes to force Japanese exports to Korea would increase more than Korean exports to Japan as Korea's average tariff rate on Japanese products is higher than Japan's average tariff rate on Korean products (7.9 per cent against 2.9 per cent). Korea's trade deficit with Japan would increase further. Moreover, many Korean firms would not be able to compete with Japanese firms producing the same products, and would face economic difficulties. On this point, the Japanese side has tried to explain that given the nature of industrial development of each country, both Japanese and Korean companies will survive the opening up through intra-industry specialization which will make them more internationally competitive. Also, the combined market or strategic alliances between the two will would attract a large number of US and European firms to invest in the two countries. This is part of the dynamic effects that cannot be captured in the static analysis of simple trade creation and trade diversion.¹⁷

(f) Other Developments

Currently there are several more FTAs in the making in East Asia. Singapore is the leader in this form of regional cooperation. Apart from the ANZSCEP already in its bag, and the JSEPA just around the corner, Singapore is already in the middle of the discussion with Mexico, already had two rounds of talk with the US, and just about to start its talk with Australia on similar FTAs. Japan has just completed a joint study on the effects of the possible FTA with Chile, and had expressed its intention to set up an FTA with Mexico. Most surprising of all, perhaps, is China which so far has not entered into any preferential trade agreement with anyone. During the so-called ASEAN plus Three meeting between ASEAN members and China, Japan and Korea during the 4th Informal ASEAN Summit in Singapore in November 2000, Mr. Zhu Rong Ji, the Chinese Prime Minister, surprised everyone by proposing an FTA between ASEAN and China. An expert group will be set up to study such a possibility in due course.

The US position on this emerging trend of the proliferation of FTAs in East Asia is of great interest. Apart from its FTA with

¹⁶ See, for example, Yamazawa (2001).

¹⁷ It seems that the primary concern of growing trade deficit from the Korean side was allayed by its further study on the trade effects of the FTA, and by the Japanese promise to accommodate the suggestion of including China into the FTA. See Yamazawa (2001), p. 22.

Israel, Canada and Mexico through NAFTA, and recently with Jordan, the US has no other FTA with any country. That the US is a keen supporter of free trade is never in doubt. But it may have put its total support to multilateral trading system rather than bilateral trading arrangements. The failure of the US to successfully organise the WTO meeting (to launch a new round of multilateral trade negotiations) in Seattle in 1999 has had some effects on the new thinking in the US administration on trade issues. Judging from its recently conclusion of an FTA with Jordan, and its two rounds of talk with Singapore on the possibility of a Singapore-US FTA, it seems that the US has changed its policy stance regarding the involvement with bilateral FTAs as against multilateral trade negotiations. Nothing is clearer than the statement by Mr. Robert Zoellick, the new US Trade Representative during the submission of the Trade Policy Agenda for 2001 to the Congress on March 15, 2001. After reiterating the benefits of free trade to America and the world, Mr. Zoellick notes that while there are approximately 130 free trade agreements in force globally, the US is a party to just two. Then this is what he said:¹⁸

“America’s absence from the proliferation of trade accords hurts our exporters. To cite just one example, while US exports to Chile face an 8 per cent tariff, the Canada-Chile trade agreement frees Canadian imports of this duty. If other countries go ahead with free trade agreements and the United States does not, we must blame ourselves. We have to get back into this game and take the lead. We are certainly in a position to do so. Indeed, the United States will be pursuing a number of regional free trade agreements in the years ahead, though not to the exclusion of global talks and the WTO process. The fact that the United States can move on multiple fronts increases our leverage in the global round...”

So, the US is now also in the game of bilateralism or subregionalism concurrently with its traditional support of multilateralism. In April 2001, President Bush will go to Quebec to participate in the meeting of the Free Trade Area of the Americas (FTAA) with a plan to rekindle its serious interest in making this FTA possible. Early on we have pointed out that Japan has just changed its position regarding world trading arrangements from strictly multilateral support to a multi-layered approach to trade policy whereby Japan will continue to base its trade policy on the rules and procedures of the WTO while simultaneously pursuing bilateral agreements with neighbours and key trade partners. When the world’s no. 1 and no. 2 economic powers decided that

¹⁸ See Zoellick (2001), p. 3. It should be noted also that C. Fred Bergsten, a well-known American expert on international trade and finance also warns the US of losing its grips as the world leader on trade if it fails to realize the impending threat from East Asia as a trade bloc. See Bergsten (2001).

this is what they will do from now on, they are likely to set the trend for others to follow.

5. Trade and Investment Consequences of FTAs in East Asia

Up to this point, we have argued strongly that the New FTAs in East Asia, within or under APEC membership, which is consistent with the principles of WTO, having convenient accession clause, forward-looking beyond the short-term benefits of tariff reduction, will generate dynamic benefits for both members and non-members in the long run. In this section, we will briefly mention the trade and investment consequence of such New FTAs in East Asia.

Intra-regional trade in East Asia happened on its own even without any form of regional trade agreements. Countries in East Asia trade with one another more frequently than any other regions except Western Europe and North America because they benefit from market mechanism, not from non-market, exclusive-group, privileges. As can be seen from Table 1, intra-regional trade within East Asia is always higher than intra-regional trade with Latin America, and the share of East Asian trade with NAFTA, EU and Oceania is also always higher than the share of Latin American trade with the same groups of countries. For example, in 1970, the intra-regional trade within East Asia was about 28.7 per cent of the total East Asian trade, compared to 11.2 per cent in Latin America. In 1998, these figures increased to 38.4 per cent for East Asia, but still only 31.4 per cent for Latin America. As for the share of East Asia in its trade with other regions, the share of East Asian trade with the EU was 3.3 per cent of the total EU trade in 1970, and increased to 11.0 per cent in 1998, whereas for Latin America, the share actually fell from 3.1 per cent in 1970 to 2.3 per cent in 1998. This has shown quite conclusively that the dynamism of trade both within East Asia itself and between East Asia and the rest of the world is reasonably high. Table 1 does not report the trade share beyond 1998 which was a start of crisis years for many East Asian countries. But it is quite likely the trade share will show even higher numbers because the devalued currencies would be a natural cause for increased trade between East Asia and other regions (especially exports from East Asia to the rest of the world). So, with countries or economies in the region showing their serious interest in pursuing greater trade and economic activities with one another, there is no reason to doubt that the overall trade within the region will increase, especially in the post-crisis period.

The same thing could be said about investment situations. One of the most important dynamic effects of the New FTAs in East Asia is the increase in foreign direct investments from outside as a result of larger markets, more efficient economic policy, and more

coordinated trade policy. As can be seen from Table 2, even in the traditional net exporters of capital like Japan, Hong Kong and Taiwan, in the last few years we have seen an increase in direct investment coming to these countries or economies from the outside. Only Korea which was a net capital exporter before the crisis has turned capital receiver after the crisis. But this will not be for long. Once the crisis is over, Korea should be able to assume the position of capital exporter through direct investment abroad again. During the crisis in 1997 and 1998, many crisis countries in East Asia namely Thailand, Indonesia and Philippines had shown a net increase in foreign direct investment. At least this has gone to show that these economies are still a good choice of investment. With extensive network of FTAs in the region, it is not unreasonable to see a further increase in this foreign direct investment coming into the region.

Before closing, we would like to refer to a study by Davis, McKibbin and Stoeckle (2000) again. This group of researchers had tried to estimate the size of investment and capital inflows as a result of the formation of AFTA-CER FTA. They believed that the trade liberalisation under AFTA-CER would cause the more efficient use of resources and improve access to markets. Hence, AFTA-CER would lift productivity and income in each member economy. The improved efficiency and any gains in the terms of trade would also lift the return on capital in each economy. They found that after forming the AFTA-CER FTA all member economies should experience a capital inflow under all scenarios. These positive capital inflows can be significant, and for AFTA the extra capital inflow from AFTA-CER liberalisation should amount to some US\$30.9 billion over the decade to 2010 (in discounted terms), and for the CER, the extra capital inflow should be about US\$7.7 billion. If the liberalisation is considered on the APEC-wide basis, the gains to both AFTA and CER would even be larger mainly because APEC represents a much more extensive liberalisation. As APEC liberalisation is on an open regionalism basis—that is, countries offer APEC tariff cuts on an MFN basis. The AFTA-CER FTA liberalises trade between members but not necessarily with third countries, but APEC is really a ‘series of simultaneous unilateral MFN liberalisations’ by a group of 21 economies. Hence a much larger gains.¹⁹

6. Summary and Concluding Remarks: Future of FTAs as an Emerging Form of Regional Cooperation in East Asia

¹⁹ See Davis, McKibbin, and Stoeckle (2000), p. 27. The above result should not be interpreted that since gains from APEC is larger, there should not be any attempt to form an FTA outside APEC. If the gains from an FTA is immediate while the longer-term liberalisation through APEC is continuing, there is no harm in doing the two things together.

In this paper we have attempted to show that there is no conclusive theoretical or empirical evidence that disparages the formation of a bilateral free trade agreement in today's world. The dynamic effects from such formation through greater economic efficiency, economy of scale, larger markets, incentives to reform, increase in investment from outside may be large enough to outweigh negative effects of possible trade diversions. If the preferential trade arrangement is comprehensive, with opportunities open for other members to join in, or without real intention to discriminate against outsiders, then the benefits would become even more real. Under the dual system of bilateral agreements and multilateral liberalisation through the APEC process, the chance of success is even greater because APEC system supports open regionalism where tariff cuts can also be offered to others unilaterally, and there are other trade and investment facilitation activities as well. Moreover, the basic principle of voluntarism and the spirit of cooperation among APEC members may indeed create a 'peer pressure' that works towards continued cohesiveness in the efforts to bring about the goals of free trade and investment in the Asia Pacific region within 20 years from now. It is not only possible to maintain such dual system of bilateralism and multilateralism within the context of APEC process, it may advisable to expand this system to other members who are still sceptical to the idea. The two largest economies in the world today, the US and Japan, are now behind this dual system.

So, we are certain to see the news about the formation of these New FTAs in East Asia or the Asia Pacific region in the years to come. It is possible, of course, that some countries or economies in the region may want to use this New FTA to cover some weaknesses in their own economies, to get into an agreement to hide something, to create what can be called an 'interest diversion' away from things that cannot be changed quickly like certain protections in some industries, sensitive sectors in others, be it agriculture or manufacturing, trade in goods or services, mutual recognition or dispute settlement, and so on. We must not allow such interest diversion to affect the way in which the New FTA should be formed. There should be no room for any country to make excuses for short-term benefits, but the New FTAs in East Asia should be the model on which others can follow, or a benchmark against which their success in regional cooperation could be measured.

Finally, an interesting observation can be made regarding the changing nature of APEC as a result of the wide-spread popularity of FTAs as an emerging form of regional cooperation. While the trade and investment liberalization aspect of APEC will continue to define a major objective of APEC through its Individual Action Plan

(IAP) on the elimination of tariff and other non-tariff barriers, the emphasis on this aspect may be greatly supplemented by two other objectives of APEC, that is trade and investment facilitation, and economic and technical cooperation. Some scholars are concerned that the progress towards Bogor goals among APEC members are not as fast as it should be, but it is unrealistic to expect that the movement towards the Bogor goals will be a straight-line tariff reductions and other trade liberalization measures between now and the year 2010 or 2020. Such movement for some economies may be in steps, with jumps and kinks, and for some, the desired change may come much closer toward the deadline. That is why the trade and investment liberalization part can be assisted by the New FTAs. In the meantime, the trade and investment facilitation, and economic and technical cooperation parts will increase in their relevance and importance. This will enhance rather than jeopardize the prospects of APEC as still one of the most interesting and exciting regional groupings in the world today.

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BOX 1: INSIDE APEC: A VIEW FROM AN OUTSIDER

By Medhi Krongkaew

Most of us today have heard about APEC although not many would know what it is or how it works. So, through this short article, I would like to say something about what APEC is and how it works, from the point of an outsider who happens to get deeply involved with the APEC process at the moment.

I was appointed Chair of the Economic and Technical Cooperation Subcommittee of APEC by APEC ministers in Auckland 1999 for a 2-year term starting January 2000. Normally this job is for diplomat or bureaucrat in APEC member economies. But how could an outsider academic like me get in? The answer was a combination of an experiment of my government, Thailand, to introduce an outsider to work inside the APEC process, and the broadmindedness of the APEC senior officials and ministers to try this new experiment. This gives me a marvelous opportunity to peer inside the working mechanisms of APEC.

APEC was set up in 1989 as a loose organization in support of free and open trade and investment in the Asia Pacific region. This orientation towards free and open trade and investment was the first and foremost guiding principle for its advent and existence. But equally important is another guiding principle of voluntary commitments. What this means is that members will not be forced to accept any agreements or commitments against their wills. This makes APEC different from WTO in the sense that WTO is a rule-based organisation, where an agreement once accepted is binding to all members, whereas in APEC some members may open up for free trade and investment unilaterally first, with other members to follow when they are ready. Within a stipulated time horizon, that is 2010 for developed members and 2020 for developing members, APEC members can trade and invest freely with one another. In this sense, APEC complements WTO and sets a moral standard, if not practical example, for others to follow.

To remain forward-looking in a loose organisation like this is not an easy matter. That is why APEC has set up working mechanisms or procedures that have become more or less institutionalised soon after the grouping came into being. Each year one member will take turn hosting the annual 'Summit' of APEC leaders. This is the highest form of decision making in APEC. Below that is the meeting of APEC ministers which also takes place once a year just before the Summit, so that what the leaders have decided to do have already been agreed upon by their responsible ministers. Little known to the general public, however, is the fact that it is the

meetings of senior officials of APEC member economies that prepare all the agreements for their ministers and subsequently their leaders. These senior officials meet up to 4 times a year at regular interval, and go through all the motions of promoting free trade and investment in the region. It is through these senior official meetings that I get deeply involved.

From the beginning, a major task of senior officials of APEC is to find ways to promote trade and investment liberalisation and facilitation, or TILF as it is known

within APEC circle. A specific committee called Committee on Trade and Investment or CTI was set up to help these senior officials manage these TILF agendas which include such important activities as the announcement of individual action plans on reduction of tariffs and non-tariff barriers, and the collective action plans on such facilitation matters as standards and conformance, customs procedures, mutual recognition agreements, dispute settlement procedures, and so on. In 1995, as a result of the APEC Summit in Osaka, other major activities within APEC were established. This is economic and technical cooperation or ECOTECH which has since then become the 'third pillar' of APEC (after trade and investment liberalisation and facilitation). In 1997, a special subcommittee was set up to, again, help senior officials manage their ECOTECH agendas, and it is called ECOTECH Subcommittee or ESC, for short. The reason this new organisation is a subcommittee rather than a committee like CTI is pure politics: some members were afraid that, by giving greater attention to ECOTECH, the focus on TILF might be blurred. So, a compromise was reached that this new group is to be set up as a subcommittee working directly under senior officials. In practice, however, this status of ESC is very much the same as CTI.

So, throughout the year, various organisations within APEC including my ESC are having a lot to do within their own roles and jurisdiction. The work program for my ESC for this year, for example, includes the revision of Part 2 of the Osaka Action Agenda which sets activities for various working groups within APEC to undertake to enhance economic and technical cooperation within APEC, the drafting of strategy for human capacity building, the preparation for the possible launch of the first ECOTECH individual action plan, and so on. The ways in which these APEC officials perceive and respond to APEC tasks make a good impression on an outsider like me, that they take APEC seriously and are willing to go through the difficult preparation for an eventual freer trade and investment in the region, while, at the same time, pursue the activities that promote economic and technical cooperation among members so that all can reach the goals of 2010 and 2020 faster. It

is this feeling that makes my participation in the APEC process very refreshing and rewarding indeed.

Box 2: The ANGKOR AGENDA—Report of the High-Level Task Force on the AFTA-CER Free Trade Area

In an attempt to establish closer economic partnership between AFTA and CER, ASEAN and CER Ministers agreed to set up a High-Level Task Force to explore the feasibility of an AFTA-CER free trade area by 2010. This Task Force consisted of a group of former senior political figures, academic and senior officials of each of the ASEAN countries as well as Australia and New Zealand. The Third and final meeting of this Task Force was held in the exotic city of Siem Reap in Cambodia, the site of the Angkor Wat, in August 2000. Hence the catchy name of this report which was considered by AFTA-CER Ministers at the 5th annual consultations in Chiang Mai, Thailand in October 2000.

What is special about this report is that it has detailed the benefits and costs of the prospective AFTA-CER in a succinct yet systematic and comprehensive manner. At the end, the Task Force has set out a series of principles that can be used to guide the proposed formation of the AFTA-CER FTA, which indeed could also be the guiding principles of any New FTA. These principles are as follows:

- (a) The AFTA-CER FTA would represent a separate arrangement which would be comprehensive, covering all goods, services and investments, and would lead to the elimination of all forms of tariff and non-tariff barriers to trade in goods and services. AFTA and CER would maintain their respective identities;
- (b) The AFTA-CER FTA should be mutually beneficial to each group and to all member countries of the respective groups;
- (c) The pace of liberalisation within the AFTA-CER FTA should proceed faster than that agreed within APEC, i.e. 2010 for developed economies and 2020 for developing economies;
- (d) Subject to new arrangements that may be achieved within AFTA, the AFTA-CER FTA would not normally go beyond the pace of liberalisation which AFTA has already agreed for ASEAN members, i.e. Elimination of tariffs for manufactured goods by 2010 for ASEAN-6 and 2015 for the four new members, with some flexibility. CER would progressively reduce tariffs for ASEAN from the conclusion of negotiations, reaching free trade by 2005;
- (e) The AFTA-CER FTA would be open to inclusion of new issues not currently covered by the AFTA or CER Agreements. In these cases, members of either group could decide to exclude themselves temporarily from the agreements;
- (f) The AFTA-CER FTA would comprise both developed and developing countries with different needs and levels of development. Hence, the structural adjustment and flexibility needed should also be recognised. The proposed FTA should provide development assistance in the form of capacity-building

measures and technical assistance and the adoption of a longer time-frame for the newer members of ASEAN;

- (g) The AFTA-CER FTA would be open to accession by any other country or regional grouping that shares the common principles and underlying objectives of the FTA;
- (h) The provisions of CER and AFTA are different. Neither is an appropriate base model for an AFTA-CER FTA. However, elements of either CER or AFTA may be incorporated in the proposed AFTA-CER FTA agreement; and
- (i) AFTA and CER will continue to exist as functioning agreements.

Source: The ANGKOR AGENDA—Report of the High-Level Task Force on the AFTA-CER Free Trade Area, obtainable from the website of the Australian Department of Foreign Affairs and Trade

Box 3: A Template for Free Trade Agreement

While an actual FTA for a pair of country can vary widely depending on the intention and design of trading partners, it is possible to draw or construct a template or model for free trade agreement between any trading partners. This is exactly what Keidanren, the Japanese Federation of Economic Organisations representing the private-sector businesses in Japan, has done for the Japanese government based on the North American Free Trade Agreement (NAFTA) and the EU-Mexico Free Trade Agreement. The skeleton or structure of this template is as follows:

Preamble

- I. Liberalisation of Intra-Regional Trade
 1. Elimination of tariffs on goods
 2. Non-tariff measures
 - National treatment
 - Prohibition of quantitative restrictions
 - Prohibition of export subsidies
 - Customs operation
 3. Liberalisation of trade in services
 - Scope and coverage
 - National treatment and market access
 - Liberalisation schedule
- II. Rules on Intra-Regional Trade
 1. Rules of origin
 2. Anti-dumping
 3. Safeguards
 - Intra-regional safeguards
 - Global safeguards
- III. Investment Protection and Liberalisation
 - Definition of investors and investment
 - Scope and coverage
 - Treatment of investors and investment
 - Transparency
 - Prohibition of performance requirements
 - Temporary entry, stays and employment of investors and key personnel
 - Prohibition of nationality requirements
 - Expropriation and compensation
 - Dispute settlement
 - Exceptions

- IV. Rules for Trade and Investment Facilitation
 - 1. Harmonisation and mutual recognition of standards and conformity assessment systems, etc.
 - 2. Intellectual property rights
 - 3. Government procurement
 - 4. Facilitation of the movement of business persons
 - 5. Competition policy
 - 6. Electronic commerce
- V. Dispute Settlement
 - Definition of 'dispute'
 - Dispute settlement procedures
 - Relation with WTO dispute settlement procedures

Source: Keidanren, "A Model Free Trade Agreement", Urgent Call for Active Promotion of Free Trade Agreement—Toward a New Dimension in Trade Policy, 18 July 2000.

Table 1: Intra and Inter-Regional Trade Share, by Region (%)

		1970	1975	1980	1985	1990	1995	1996	1997	1998
Exporting region	Importing region									
NAFTA	NAFTA	36.0	34.6	33.6	43.9	41.4	46.2	47.6	49.1	51.0
	Latin America	8.1	8.9	8.6	5.6	4.8	6.7	6.7	7.1	7.3
	East Asia	17.6	15.2	16.8	14.7	18.7	20.2	20.0	18.1	15.2
	EU	23.3	19.5	21.6	17.0	19.6	16.2	15.4	15.4	16.4
	CER	2.2	1.7	1.8	2.1	1.9	1.6	1.6	1.5	1.5
Latin America	NAFTA	32.2	33.8	28.7	33.2	35.0	27.0	28.9	29.2	28.3
	Latin America	11.2	11.9	16.9	11.9	13.7	26.7	27.4	28.4	31.4
	East Asia	5.4	4.8	6.3	6.5	8.8	11.5	10.9	9.9	8.3
	EU	33.2	26.8	21.4	25.7	24.1	23.1	21.1	19.3	19.4
	CER	0.1	0.1	0.2	0.5	0.4	0.4	0.3	0.3	0.2
East Asia	NAFTA	32.5	23.5	23.5	33.4	28.0	24.0	23.3	23.8	26.3
	Latin America	3.7	6.0	4.7	2.8	1.8	2.6	2.5	2.8	2.7
	East Asia	28.7	28.6	32.7	31.8	35.7	39.0	43.5	43.4	38.4
	EU	13.5	13.4	14.4	11.4	16.2	13.7	12.1	13.5	14.0
	CER	3.4	3.4	2.8	7.0	2.2	1.6	1.8	2.0	2.7
EU	NAFTA	9.7	6.9	6.7	11.2	8.2	7.7	7.9	8.6	9.6
	Latin America	3.1	3.5	3.3	1.8	1.2	2.3	2.3	2.2	2.3
	East Asia	3.3	2.9	3.1	4.1	5.1	7.2	7.3	7.0	11.0
	EU	48.7	48.4	50.9	50.3	55.0	62.4	61.4	55.8	56.1
	CER	1.6	1.2	2.8	1.0	0.8	0.8	0.8	0.8	0.8
CER	NAFTA	16.9	13.4	14.4	12.8	13.5	8.9	8.8	9.7	11.8
	Latin America	0.7	1.9	1.2	1.0	0.9	1.3	1.7	1.4	1.6
	East Asia	32.6	39.1	38.5	40.8	44.3	50.9	45.6	48.2	43.1
	EU	24.7	17.3	14.1	13.1	12.1	11.7	11.5	10.2	13.2
	CER	6.1	6.1	6.4	7.0	7.6	9.9	9.7	9.5	8.3

Note: NAFTA (US, Canada, Mexico), Latin America (excludes Mexico)

East Asia (Japan, China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Thailand, excluding Taiwan)

CER (Australia, New Zealand)

Source: Adapted from Hosono and Nishijima (2001), based on IMF, Direction of Trade.

Table 2: Outward and Inward Direct Investment of Selected Countries in East Asia (US\$ million)

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Japan										
- Outward	50,497	31,620	17,390	13,834	18,089	22,508	23,442	26,059	24,625	22,267
- Inward	1,777	1,286	2,760	119	912	39	200	3,200	3,268	12,308
- Net Flow	-48,720	-30,334	-14,630	-13,715	-17,177	-22,469	-23,242	-22,859	-21,357	-9,959
China										
- Outward	830	913	4,000	4,400	2,000	2,000	2,114	2,563	2,634	1,775
- Inward	3,487	4,366	11,156	27,515	33,787	35,849	40,180	44,236	43,751	38,753
- Net Flow	2,657	3,453	7,156	23,115	31,787	33,849	38,066	41,673	41,117	36,978
Hong Kong										
- Outward									16,973	19,895
- Inward									14,776	23,068
- Net Flow									-2,197	3,173
Korea										
- Outward	1,052	1,489	1,162	1,340	2,461	3,552	4,671	4,449	4,740	4,198
- Inward	788	1,180	728	589	810	1,776	2,326	2,844	5,412	9,333
- Net Flow	-264	-309	-434	-751	-1,651	-1,776	-2,345	-1,605	672	5,135
Taiwan										
- Outward	5,249	2,055	1,967	2,611	2,640	2,983	3,843	5,243	3,836	4,420
- Inward	1,330	1,271	879	917	1,375	1,559	1,864	2,248	222	2,926
- Net Flow	-3,919	-784	-1,088	-1,694	-1,265	-1,424	-1,979	-2,995	-3,614	-1,494
Indonesia										
- Outward	0	0	0	356	609	603	600	178	44	72
- Inward	1,093	1,482	1,777	2,004	2,109	4,346	6,194	4,677	356	2,745
- Net Flow	1,093	1,482	1,777	1,648	1,500	3,743	5,594	4,499	312	2,673
Malaysia										
- Outward	0	0	0	0	0	0	0	0	0	0
- Inward	2,332	3,998	5,183	5,006	4,342	4,178	5,078	5,137	2,163	1,553
- Net Flow	2,332	3,998	5,183	5,006	4,342	4,178	5,078	5,137	2,163	1,553
Philippines										
- Outward	0	0	0	374	302	399	182	136	160	59
- Inward	530	544	228	1,238	1,591	1,478	1,517	1,222	2,287	573
- Net Flow	530	544	228	864	1,289	1,079	1,335	1,086	2,127	514
Singapore										
- Outward	2,034	526	1,317	2,152	4,577	6,281	6,935	8,858	1,525	3,943
- Inward	5,575	4,887	2,204	4,686	8,550	7,206	8,984	8,085	5,493	6,984
- Net Flow	3,541	4,361	887	2,534	3,973	925	2,049	-773	3,968	3,041
Thailand										
- Outward	140	167	147	233	493	886	931	580	130	346
- Inward	2,444	2,014	2,113	1,804	1,366	2,068	2,336	3,895	7,315	6,213
- Net Flow	2,304	1,847	1,966	1,571	873	1,182	1,405	3,315	7,185	5,867
Vietnam										
- Outward										
- Inward										
- Net Flow	120	220	260	300	1,048	1,400	1,803	2,587	1,845	1,484

Source: The International Centre for the Study of East Asian Development (ICSEAD), ***East Asian Economic Perspectives***, vol. 12, Special Issue, February 2001.